

# *The Perception Gap on Energy Security: East Asia and the United States*

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Energy security, as well as climate change, has been a hotly discussed topic in the past few years with the rapid growth of global energy demand and the upsurge of the price of oil. To deal with these challenges, most countries have been looking for bilateral or multilateral international energy cooperation while carrying out new domestic energy policies. Energy security cooperation between East Asia and the United States, with the world's top three oil consumers and importers among them, attracts a lot of attention. There is no doubt that there has been some progress in the past few years, yet there is still a lot to be done.

Among the factors affecting energy security cooperation between East Asia and the United States, the perception gap on energy security plays an important role. Although all the main players in this region—the United States, China, Japan and the ROK—are in same position of being big oil consumers and importers, the definition of energy security and the perception of energy-related issues are quite different between East Asia and the United States, especially with respect to China and the United States.

As developed countries and members of the OECD, to some extent Japan and the ROK should have more of a common interest with the United States in terms of energy security. Nevertheless, regarding the definition of energy security and how to safeguard energy security, the Japanese and Koreans, being Asian, share a viewpoint more in line with that of China. To further energy security cooperation between East Asia and the United States, reducing the perception gap—especially for a number of misperceptions and misunderstandings of one other—is very much needed. Understanding of the existence of the perception gap and misperceptions on energy security between the East and West, and between China and the United States, is particularly crucial for the policy-making community.

Within the gap in perception, at the minimum two points need to be addressed. **Firstly, East Asia's definition of energy security is different from that of the United States, particularly with respect to energy security issues.** Energy security is a widespread but poorly understood concept, and there is still no consistent definition. Due to differences in culture, language and stage of development, Asians—particularly the Chinese—lay great stress on energy-supply security to maintain economic growth, whereas most Western analysts, especially from the United States, focus more on the international implications of Asia's energy activities and policies. Both sides are talking about energy security, yet in actuality Asians talk more about the first part, energy, and Americans talk more about the second part, security.

The energy challenges faced by China include the rapid growth of energy demand and imports, increasing energy-related environmental problems, a poor energy structure and low energy-efficiency, as well as an undeveloped energy market. To deal with these challenges, China is paying more attention to demand-side management and pushing forward energy-market reforms while encouraging the diversification of the energy structure and imports. Energy conservation has been gradually recognized as a resource by the Chinese government. China plans to reduce the energy consumption per unit of GDP as at the end of 2005 by 20% by 2010. The new law on renewable energy took effect on 1 January 2006. In June 2007, the Chinese government released China's National Climate Change Program. In the past few years, China has made great progress in the area of the improvement of energy efficiency and clean energy development.

Meanwhile, what attracts the United States and the West most is China's energy cooperation with producers which don't have good relations with the United States, and hotly debated issues such as the "Malacca Dilemma." Regarding China's overseas energy activities, the United States' main concern is the growing involvement of China's energy sector in a number of "problem" states. What worries the Americans is that if and when energy security becomes a vested interest for China, a heightened sense of insecurity, especially with regard to US policies, may trigger more assertive action in the long term.

Most Chinese analysts argue that what China has been doing is just a normal reaction to the growing energy challenges, and conforms to what other countries have been doing, including importing, pursuing energy diplomacy and supporting overseas investment.

Thus China feels that it is blamed for almost everything related to energy, ranging from the high world oil price, to environmental pollution, to humanitarian disaster in Sudan, and cannot rightly understand why the West focuses mostly on overseas investment and so-called energy diplomacy and pays less attention to what China has been doing, such as improving energy efficiency and energy conservation, encouraging the diversification of its energy structure and pushing forward energy-market reforms. In addition to the theory of "China's energy threat" widespread in the West, all these things have already heightened China's strong sense of energy insecurity rooted in a growing dependence on energy imports.

There are so many major contributing factors that China's energy activities cannot be understood properly by the Western analyst. China and the West have different

understandings of energy security and risks. Due to the transition and adjustment from the planned economy to a market economy, it is inevitable that some Chinese analysts have some misperceptions of the West, and inappropriate reactions and explanations. Just as Professor Zha Daojiong mentioned, "Discussions ignoring market basics get more attention."<sup>1</sup> Since China lost its self-sufficiency in its oil supply, Chinese concern about oil-supply security and a feeling of energy insecurity have become widespread, from the level of the ordinary citizen up to that of the government. Apart from the needs resulting from economic development, there is also a feeling of crisis.<sup>2</sup>

In recent years, the United States launched the Afghanistan and Iraq wars, and further expanded its military presence in Central Asia and the Indian Ocean, all increasing China's sense of energy insecurity. The risk of transportation accidents, the safety of sea-lanes through such choke points as the Hormuz and Malacca straits, and in addition the risk of embargoes, are under serious consideration also among some Chinese analysts. With more and more oil tankers shuttling along those routes, controlled by the United States navy, it's true that a number of Chinese scholars have "become more worried about an American oil blockade."<sup>3</sup> In any case the "Malacca dilemma" is overstated among analysts and the media. Whether in terms of strategy or technology, with the ever-increasing interdependence of China and the United States, it is unlikely the United States would impose an oil blockade against China. Compared with the other challenges to energy security and national security, the risks from pirates and terrorism, or accidents, are not such a big deal.

Unfortunately, some Western analysts' perception of China's energy policy and activity are only partly based on the above-mentioned Chinese misperceptions. The Western analysts tend to believe, more or less, that faced with energy-security challenges, the Chinese government has sought an energy security strategy focusing on overseas energy procurement and worked hard to carry out it. In the eyes of some Western analysts, China's energy security policy is explained as acquiring energy-supply security through upstream investment or by obtaining equity oil in foreign energy and resource enterprises. China is also blamed for taking a "strategic approach" instead of a "market approach", taking oil "off the market" and inciting its nationally-owned oil companies to grab oil resources abroad. To some extent, China's energy policy and activity are explained as a worldwide search for energy security.

**Secondly, as to how to deal with the energy-security issues,** the responses of East Asia and the United States are also quite different. Since the two oil crises of the 1970s, in the United States energy independence has been very

high on the government's list of priorities. Former-president Bush called for a decrease in the United States' dependence on Middle Eastern oil of approximately 75 percent; President Obama has been talking about energy dependence since he entered the presidential election campaign, and he also emphasizes a decrease in energy dependence on the Middle East and Latin America. Both the Democrats and Republicans are seeking to be energy-independent no matter what kind of measures they employ; normally the Democrats focus more on government involvement and developing new and renewable energies, and the Republicans are interested in free markets and offshore drilling.

In any case East Asian countries, including China, Japan and the ROK, emphasize the government's role more and are very much interested in supporting their energy companies' overseas procurement of equity oil. It is common for state-owned oil companies to enjoy a number of advantages—ones which promote their success—over their international oil company (IOC) counterparts.

In Japan, the government encourages its companies to explore and produce overseas by providing technological, financial and diplomatic assistance. The Japanese government made the requirement in the 1970s that equity oil account for 30 percent of oil imports. To achieve this, it established the Japan National Oil Corporation (JNOC) to organize and fund overseas exploration and production and to establish a research center for oil technology in order to provide technological assistance to companies exploring and producing abroad. By 1995, about 177 companies had received technological and financial assistance from the Japanese government.

At the same time, Japan strengthened its diplomatic relations with oil exporters, especially in the Middle East. Japan's Middle East policy was quite different from that of the United States. In November 1980 Japan resumed oil imports from Iran and provided it with 38.8 billion yen in Official Development Assistance (ODA). Between 1951 and 1999, Japanese total investment (including direct investment) to 12 Middle Eastern countries amounted to 1,179 billion yen.

The Japanese government has clearly stated that it will increase the share of Japanese overseas upstream equity oil within its total oil imports from around 15 percent to 40 percent in the recently released New National Energy Strategy, even though it had failed to achieve its former 30 percent goal. To achieve the new goal, "the strategy provides a comprehensive approach toward resource-rich countries to deepen economic relations. In this effort, strategic utilization of Official Development Assistance (ODA) or forming Economic Partnership Agreements

<sup>1</sup> Zha Daojiong, "China 'Goes Out' for Energy: toward an international dialogue", presentation at the China Energy Policy Round Table staged by the Asia Centre, Beijing, 10 January 2007.

<sup>2</sup> Paul Lin, "China's Move toward Oil Diplomacy", Association for Asian Research, 4 February 2005

<sup>3</sup> "The Dragon Tucks in", *The Economist*, 2 July 2005, p. 61.

(EPAs) are considered as the means to having better economic relations with resource-rich countries. Moreover, combined efforts by government and affiliated entities, such as Nippon Export and Investment Insurance (a governmental export insurance agency in Japan) and the Japan Bank for International Cooperation, may be worth pursuing.<sup>4</sup>

Regarding governmental efforts to encourage overseas oil investment, Yoshikazu Kobayashi of the Institute of Energy Economics, Japan (IEEJ), argued that because Japanese upstream players are all small in size relative to the rival companies in other countries, their risk absorption capacities are limited, and for this reason government intervention is justified. He also mentioned that having a national-flag energy company would be certain to improve Japan's energy security.

According to the analysis of Kim Jinwoo from the Korea Energy Economics Institute, overseas energy development is the policy direction which deals with energy-security threats and resource competition. His suggestion lists upgrading energy security and fulfilling the overseas oil production policy objective of supplying 15% of oil imports in 2013 with the intensive support of government, enhanced human and organizational infrastructure, building institutional and financial foundations, and the concentration of public and private capacity.

Similarly in China, a number of analysts also tend to believe that overseas investment, especially acquiring equity oil and energy assets, should and can play an important role in safeguarding China's energy security. Some examples of this kind of analysis are as follows:

Wu Lei, the author of "China's Oil Security" pointed out: "China's overseas investment can strengthen the state-owned oil company's financial position and it's competitiveness in the world energy market, and there is positive and strategic significance in strengthening China's oil security."<sup>5</sup> When talking about bidding overseas and developing LNG, Fu Chengyu, CEO of CNOOC, said: "it is aimed at national energy security in the long run."

"The key matter for solving China's energy-supply security is going abroad, fully using foreign resources. 'Going abroad' includes two aspects: first, to import and purchase oil directly from the world market; second, to invest overseas in exploration, production and refining, and

to bring the oil back home in the return on the investment."<sup>6</sup>

"To some extent, the solution of China's oil security lies overseas and oil companies' going abroad is necessary for China to solve the domestic oil shortage and to ensure overseas energy-supply security."<sup>7</sup>

China became a net oil-importer in 1993, and coincidentally, also since the early 1990s, Chinese energy companies started to invest in overseas oil and gas projects.<sup>8</sup> Therefore people tend to believe that there must be some kind of connection between these two issues. "Go out" (sometimes translated as "going out") is a poorly understood and translated term pertaining to China's overseas energy investment, and most Western analysts explain it as "go out for energy". In addition, the hotly-discussed energy diplomacy in China and the government's financial support for state-owned oil companies' overseas investment further the impression of the connection between supporting overseas investment and ensuring energy security.

Regarding "go out," it is one of two parts of China's policy of opening up which are termed "invite in" and "go out," and are for the sake of learning from and integrating with the outside world. In the energy sector, "invite in" means lifting tariffs, opening petroleum sales and carrying out initial public offerings (IPOs) of stock. In addition to downstream oil and petrochemical projects, China has also invited international oil companies to invest upstream. "Go out" means getting involved in the world market to achieve expansions of scale and establish multinational corporations with high international competitiveness. Actually it is the company, instead of government, which goes out, and in addition the goal is to realize internationalization and maximization of profits, instead of taking equity oil back to safeguard energy security. The government's support is the advantage they are looking for and would like to make full use of it; and in any case, the state-owned companies would still continue their internationalization and overseas investment, even without the support of the government.

Unfortunately, in the eyes of some Western analysts oil companies are being used as an "appendage" to carry out the Chinese government's energy procurement strategy and foreign policy. "The goal is to use oil diplomacy to cover up its ambitions for strategic expansion."<sup>9</sup> "But these [China's] companies are essentially expected to be an arm of national foreign policy in their foreign investment, rather than to create value."<sup>10</sup> "And while foreign investment by the Chinese state companies may be a good way to develop

<sup>4</sup> Yoshikazu Kobayashi, "Japan's Energy Vision", paper at the international seminar "Quest for Energy Security in Asia", 13-14 February 2007, Islamabad.

<sup>5</sup> Wu Lei, *China's Oil Security*, p. 316, China Social Sciences Press, Beijing, 2002.

<sup>6</sup> Anniwaer Amuti and Zhang Shengwang, *Oil and National Security*, p. 289, Xinjiang People's Publishing House, Xinjiang, China, 2003.

<sup>7</sup> Shu Xianlin and Li Daifu: "China's Oil Security and Oil Company's Overseas Investment", *World Economics and Politics Forum*, No. 5, 2004.

<sup>8</sup> Gary Dirks, "Energy Security: China and the World", speech at the International Symposium on Energy Security: China and the World", Beijing, China, 24-26 May 2006.

<sup>9</sup> Paul Lin, "China's Move toward Oil Diplomacy", Association for Asian Research, 4 February 2005.

<sup>10</sup> Maria Kielmas, "China's Foreign Energy Asset Acquisitions: From Shopping Spree to Fire Sale?", *The China and Eurasia Forum Quarterly*, Vol. 3, No. 3, November 2005.

the country's foreign policy, such investment decisions are made by bureaucrats and are political, rather than aimed at providing an adequate return".<sup>11</sup>

Besides, just as Chen Xinhua, the deputy director of BP China, pointed out, that unlike most Western analysts believing that China's overseas oil and gas investment is well organized by the government and aimed at safeguarding China's energy security, it's much more akin to company behavior than to government behavior. China's oil companies' overseas investment is one part of China's integrating into the world economy. Since quite a number of companies within other sectors, such as refrigerators, computers, and color TVs, are going abroad to invest and to build factories, there is no reason to stop the oil companies from investing overseas. Just as mentioned in the report on the impact of China's overseas oil and gas bidding on US national security, issued by the US Department of Energy, China's overseas oil and gas investment and bidding will not improve China's energy security, and also will not decrease the United States' energy security either.<sup>12</sup>

Inexperience in the international market, the obvious sense of energy insecurity, and the economic and social transition, are the key factors that contribute the most to China's overseas energy activities which can't be properly understood by Western analysts. In the eyes of an expert, CNOOC more closely resembles the international majors than the more insular CNPC and Sinopec. In the case of the bid for Unocal, however, CNOOC did not play its hand well, as it had not undertaken the necessary thoroughness in articulating a clear rationale for the deal. To some extent the approach of CNOOC reflected a cultural difference and corporate inexperience when dealing with alliances and mergers. Many Chinese enterprises have yet to develop an in-depth understanding and appreciation of the challenges (many of them cultural) in merging and forming alliances with other companies.<sup>13</sup> In any case it will take time for Chinese companies to become smarter; they will make mistakes and they will need to learn faster.

The above mentioned are only part of the perception gap on energy security between East Asia and the United States. Besides, some of goals are unrealistic, and some are misperceptions of the reality of energy security. With the development of globalization and energy interdependence, energy independence is not necessary and not achievable,

and also equity oil procurement is unable to safeguard a sustainable energy supply.

There are also a number of mutual misperceptions or misunderstandings on energy security policy. Some analysts from the West, especially the United States, tend to believe that China wants to use energy diplomacy to achieve the goal of international expansion, and they take China's energy cooperation with certain rogue states as challenging the existing international global system. At the same time, some Chinese worry that the United States will intentionally contain China's development and rise by interfering with China's overseas energy cooperation and by controlling its lines of energy transportation.

The different definitions, priorities and misperceptions regarding energy security bring East Asia and the United States many difficulties concerning cooperation. To deal with these difficulties, a number of efforts have been made both by East Asia and the United States. The strategic economic dialogue (energy security is one of the top topics) between China and the United States has been very fruitful, and there have also been a number of dialogues and cooperation at different levels among scholars and officials held in the past several years.

With such dialogues and further studies, part of the gap in perception and misperceptions has already been noticed by energy specialists. For example, some American analysts have realized that Beijing gives its relationship with the United States priority over the acquisition of foreign oil assets by a Chinese NOC,<sup>14</sup> and regarding China's energy cooperation with Venezuela, the United States has no need to worry about a new anti-US axis, because the motive is different—Venezuela is seeking a geopolitical alliance and China is aiming at a stable energy supply.

Nevertheless, such ideas are still not widely accepted by most scholars, the public, the media, and governmental officials. It is not so easy for some people to change their accustomed opinions and ways of thinking. To decrease the misperceptions or misunderstandings we need more study, clarification, and education. In particular the government needs to understand what the real problems and challenges we are facing are, and what the priorities are. In this regard, China needs to explain more, and the United States and the West should listen and study more.

<sup>11</sup> *Ibid.*

<sup>12</sup> US Department of Energy, Section 1837 of the Energy Policy Act 2005: *National Security Review of International Energy Requirements*, February 2006, p. 28.

<sup>13</sup> Peter Parry, Eric Spiegel, Edward Tse, John McCreery, and Adrian del Maestro, "The Roaring Dragon: Unocal Bid Just a Minor Bump in the Road", <http://www.boozallen.com>, February 2006.

<sup>14</sup> Erica Downs, *The Brookings Foreign Policy Studies Energy Security Series: China*, December 2006, <http://www3.brookings.edu/fp/research/energy/2006China.pdf>